



**MEDSTAR HEALTH, INC.**

Consolidated Financial Statements  
and Supplementary Schedules

June 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

# MEDSTAR HEALTH, INC.

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KPMG LLP  
1 East Pratt Street  
Baltimore, MD 21202-1128

## Independent Auditors' Report

The Board of Directors  
MedStar Health, Inc.:

We have audited the accompanying consolidated balance sheets of MedStar Health, Inc. (the Corporation) as of June 30, 2012 and 2011, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of MedStar Health, Inc. as of June 30, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information included in Schedules 1 and 2 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

**KPMG LLP**

October 10, 2012

**MEDSTAR HEALTH, INC.**

## Consolidated Balance Sheets

June 30, 2012 and 2011

(Dollars in millions)

<b>Assets</b>	<b>2012</b>	<b>2011</b>
Current assets:		
Cash and cash equivalents	\$ 568.6	498.6
Investments	19.0	18.0
Assets whose use is limited or restricted	63.4	36.7
Receivables:		
From patient services (less allowances for uncollectible accounts of \$189.7 in 2012 and \$238.6 in 2011)	540.7	515.5
Other	49.1	58.7
	<u>589.8</u>	<u>574.2</u>
Inventories	48.5	47.2
Prepays and other current assets	30.5	41.8
	<u>1,319.8</u>	<u>1,216.5</u>
Total current assets		
Investments	612.3	603.8
Assets whose use is limited or restricted	376.1	390.4
Property and equipment, net	1,037.6	1,031.8
Interest in net assets of foundation	48.5	49.2
Other assets	150.5	135.1
	<u>150.5</u>	<u>135.1</u>
Total assets	<u>\$ 3,544.8</u>	<u>3,426.8</u>

**MEDSTAR HEALTH, INC.**

## Consolidated Balance Sheets

June 30, 2012 and 2011

(Dollars in millions)

<b>Liabilities and Net Assets</b>	<b>2012</b>	<b>2011</b>
Current liabilities:		
Accounts payable and accrued expenses	\$ 323.5	282.0
Accrued salaries, benefits, and payroll taxes	253.3	233.6
Amounts due to third-party payors, net	61.1	45.4
Current portion of long-term debt	18.5	37.0
Current portion of self insurance liabilities	79.5	58.0
Other current liabilities	100.8	94.2
Total current liabilities	836.7	750.2
Long-term debt, net of current portion	1,010.1	1,007.5
Self insurance liabilities, net of current portion	228.2	196.6
Pension liabilities	470.3	307.9
Other long-term liabilities, net of current portion	146.0	129.3
Total liabilities	2,691.3	2,391.5
Net assets:		
Unrestricted net assets:		
MedStar Health, Inc.	726.9	904.4
Noncontrolling interests	8.7	7.8
Total unrestricted net assets	735.6	912.2
Temporarily restricted	80.5	85.4
Permanently restricted	37.4	37.7
Total net assets	853.5	1,035.3
Total liabilities and net assets	\$ 3,544.8	3,426.8

See accompanying notes to consolidated financial statements.

**MEDSTAR HEALTH, INC.**

Consolidated Statements of Operations and Changes in Net Assets

Years ended June 30, 2012 and 2011

(Dollars in millions)

	<b>2012</b>	<b>2011</b>
Operating revenues:		
Net patient service revenue:		
Hospital inpatient services	\$ 2,145.2	2,157.6
Hospital outpatient services	1,343.3	1,227.6
Physician services	257.2	205.7
Other patient service revenue	123.9	119.6
Total net patient service revenue	3,869.6	3,710.5
Premium revenue	116.3	118.7
Other operating revenue	190.0	188.0
Net operating revenues	4,175.9	4,017.2
Operating expenses:		
Personnel	2,152.0	2,057.1
Supplies	629.7	633.4
Purchased services	514.4	499.1
Other operating	384.3	356.7
Provision for bad debts	191.3	190.7
Interest expense	45.4	44.2
Depreciation and amortization	156.5	153.0
Total operating expenses	4,073.6	3,934.2
Earnings from operations	102.3	83.0
Nonoperating gains (losses):		
Investment income	14.6	20.3
Net realized (losses) gains on investments	(9.7)	9.1
Unrealized (loss) gain on derivative instruments	(7.8)	2.7
Unrealized (losses) gains on trading investments	(13.1)	66.5
Equity interest in alternative investments	(15.4)	31.1
Income tax benefit	3.6	0.5
Other nonoperating losses	(4.6)	(1.0)
Total nonoperating (losses) gains	(32.4)	129.2
Excess of revenue over expenses	\$ 69.9	212.2

**MEDSTAR HEALTH, INC.**

Consolidated Statements of Operations and Changes in Net Assets

Years ended June 30, 2012 and 2011

(Dollars in millions)

	<b>2012</b>	<b>2011</b>
Unrestricted net assets:		
Excess of revenue over expenses	\$ 69.9	212.2
Change in funded status of defined benefit plans	(250.8)	47.4
Distributions to noncontrolling interests	(3.3)	(5.7)
Net assets released from restrictions used for purchase of property and equipment	7.6	5.0
(Decrease) increase in unrestricted net assets	(176.6)	258.9
Temporarily restricted net assets:		
Contributions	10.8	11.3
Realized net gains on restricted investments	2.2	7.2
Change in unrealized (losses) gains on restricted investments	(2.6)	5.3
Net assets released from restrictions	(15.3)	(12.4)
(Decrease) increase in temporarily restricted net assets	(4.9)	11.4
Permanently restricted net assets:		
Contributions and other	(0.3)	0.3
Realized net gains on marketable restricted investments	0.1	0.1
Change in unrealized (losses) gains on restricted investments	(0.1)	0.3
(Decrease) increase in permanently restricted net assets	(0.3)	0.7
(Decrease) increase in net assets	(181.8)	271.0
Net assets, beginning of year	1,035.3	764.3
Net assets, end of year	\$ 853.5	1,035.3

See accompanying notes to consolidated financial statements.

**MEDSTAR HEALTH, INC.**  
Consolidated Statements of Cash Flows  
Years ended June 30, 2012 and 2011  
(Dollars in millions)

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Change in net assets	\$ (181.8)	271.0
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	156.5	153.0
Amortization of bond financing costs, premiums and discounts	0.1	0.4
Loss on sale of property and equipment	0.1	0.3
Change in funded status of defined benefit plans	250.8	(47.4)
Realized net losses (gains) on marketable investments	7.4	(16.4)
Change in unrealized losses (gains) of marketable investments	15.8	(72.1)
Change in value of equity interest in alternative investments	15.4	(31.1)
Unrealized loss (gain) on derivative instrument	7.8	(2.7)
Net settlement payment on derivative instrument	4.1	4.2
Loss on extinguishment of debt	2.7	—
Distributions to noncontrolling interests	3.3	5.7
Deferred income tax benefit	(4.3)	(1.4)
Provision for bad debts	191.3	190.7
Temporarily and permanently restricted contributions	(10.5)	(11.6)
Changes in operating assets and liabilities:		
Receivables	(206.9)	(262.2)
Inventories and other assets	0.5	(3.6)
Accounts payable and accrued expenses	59.7	30.3
Amounts due to third-party payors	15.7	3.4
Other liabilities	(19.0)	(23.3)
Net cash provided by operations	<u>308.7</u>	<u>187.2</u>
Cash flows from investing activities:		
Purchases of investments and assets whose use is limited or restricted, net	(59.7)	(12.6)
Net settlement payment on derivative instrument	(4.1)	(4.2)
Purchases of property and equipment and other	(164.8)	(170.2)
Net cash used in investing activities	<u>(228.6)</u>	<u>(187.0)</u>
Cash flows from financing activities:		
Proceeds from long-term borrowings	136.6	—
Repayment of long-term borrowings	(152.5)	(17.1)
Payment of deferred issuance costs	(1.4)	—
Temporarily and permanently restricted contributions and other	10.5	11.6
Distributions to noncontrolling interests	(3.3)	(5.7)
Net cash used in financing activities	<u>(10.1)</u>	<u>(11.2)</u>
Increase (decrease) in cash and cash equivalents	70.0	(11.0)
Cash and cash equivalents at beginning of year	<u>498.6</u>	<u>509.6</u>
Cash and cash equivalents at end of year	<u>\$ 568.6</u>	<u>498.6</u>
Supplemental disclosure of cash flow information:		
Interest paid	\$ 44.8	45.5
Noncash investing and financing activities:		
Accounts payable for fixed asset purchases	\$ 5.7	5.4

See accompanying notes to consolidated financial statements.



## **MEDSTAR HEALTH, INC.**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(Dollars in millions)

### **(1) Description of Organization and Summary of Significant Accounting Policies**

#### **(a) Organization**

MedStar Health, Inc. (the Corporation) is a tax-exempt, Maryland membership corporation which, through its controlled entities and other affiliates, provides and manages healthcare services in the region encompassing Maryland, Washington D.C. and Northern Virginia. The Corporation became operational on June 30, 1998 by the transfer of the membership interests of Helix Health, Inc. (Helix – a not-for-profit Maryland Corporation) and Medlantic Healthcare Group, Inc. (Medlantic – a not-for-profit Delaware Corporation) in exchange for the guarantee of the debt of both Helix and Medlantic by the Corporation. The trade names of the principal tax-exempt and taxable entities of the Corporation are:

#### **Tax-Exempt**

- Bay Development Corporation
- Church Home and Hospital of the City of Baltimore, Inc.
- MedStar Franklin Square Medical Center
- MedStar Harbor Hospital
- HH MedStar Health, Inc.
- MedStar Georgetown University Hospital
- MedStar Health Research Institute
- MedStar Health Visiting Nurse Association
- MedStar Surgery Center, Inc.
- MedStar Montgomery Medical Center
- MedStar National Rehabilitation Network
- MedStar Good Samaritan Hospital
- MedStar Union Memorial Hospital
- MedStar St. Mary's Hospital
- MedStar Washington Hospital Center

#### **Taxable**

- Greenspring Financial Insurance, LTD.
- MedStar Enterprises, Inc. and Subsidiaries
- MedStar Physician Partners, Inc.
- Parkway Ventures, Inc. and Subsidiaries

## **MEDSTAR HEALTH, INC.**

### Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(Dollars in millions)

**(b) *Basis of Presentation***

The consolidated financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles. All majority owned and direct member entities are consolidated. All entities where the Corporation exercises significant influence but for which it does not have control are accounted for under the equity method. All other entities are accounted for under the cost method. All significant intercompany accounts and transactions have been eliminated.

**(c) *Use of Estimates***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**(d) *Cash Equivalents***

All highly liquid investments with a maturity date of three months or less when purchased are considered to be cash equivalents.

**(e) *Investments and Assets whose use is Limited or Restricted***

The Corporation's investment portfolio is considered trading and is classified as current or noncurrent assets based on management's intention as to use. All debt and equity securities are reported at fair value principally based on quoted market prices on the consolidated balance sheets.

The Corporation has investments which under U.S. generally accepted accounting principles are considered alternative investments, including commingled equity funds totaling \$67.5 and \$95.2 at June 30, 2012 and 2011, respectively; inflation hedging equity, commodity, and fixed income funds totaling \$57.0 and \$64.9 at June 30, 2012 and 2011, respectively, and hedge fund of funds and private equity totaling \$137.0 and \$108.4 at June 30, 2012 and 2011, respectively. These funds utilize various types of debt and equity securities and derivative instruments in their investment strategies. Alternative investments are recorded under the equity method and the change in equity interest is included in nonoperating gains (losses) on the consolidated statements of operations and changes in net assets.

Investments in unconsolidated affiliates are accounted for under the cost or equity method of accounting, as appropriate and are included in other assets in the consolidated balance sheets. The Corporation utilizes the equity method of accounting for its investments in entities over which it exercises significant influence. The Corporation's equity income or loss is recognized in other operating revenue on the consolidated statements of operations and changes in net assets.

Investments limited as to use or restricted include assets held by trustees under bond indenture, self-insurance trust arrangements, assets restricted by donor, and assets designated by the Board of Directors for future capital improvements and other purposes over which it retains control and may, at its discretion, use for other purposes. Amounts from these funds required to meet current liabilities

**MEDSTAR HEALTH, INC.**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(Dollars in millions)

have been classified in the consolidated balance sheets as current assets. Purchases and sales of securities are recorded on a trade-date basis.

Investment income (interest and dividends) including realized gains and losses on investment sales are reported as nonoperating gains or losses in the excess of revenues over expenses in the accompanying consolidated statements of operations and changes in net assets unless the income or loss is restricted by the donor or law. Investment income on funds held in trust for self-insurance purposes is included in other operating revenue. Investment income and net gains (losses) that are restricted by the donor are recorded as a component of changes in temporarily or permanently restricted net assets, in accordance with donor imposed restrictions. Realized gains and losses are determined based on the specific security's original purchase price or adjusted cost if the investment was previously determined to be other-than-temporarily impaired. Unrealized gains and losses are included in nonoperating gains (losses) within the excess of revenue over expenses.

**(f) Inventories**

Inventories, which primarily consist of medical supplies and pharmaceuticals at many of the operating entities, are stated at the lower of cost or market, with cost being determined primarily under the average cost or first-in, first-out methods.

**(g) Property and Equipment**

Property and equipment acquisitions are recorded at cost and are depreciated or amortized over the estimated useful lives of the assets. Estimated useful lives range from three to forty years. Amortization of assets held under capital leases are computed using the shorter of the lease term or the estimated useful life of the leased asset and is included in depreciation and amortization expense. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Interest expense capitalized totaled \$0.2 and \$1.3 for 2012 and 2011, respectively, which was offset by investment earnings of \$0 and \$0.1, respectively. Depreciation is computed on a straight-line basis. Major classes and estimated useful lives of property and equipment are as follows:

Leasehold improvements	Lease term
Buildings and improvements	10 – 40 years
Equipment	3 – 20 years

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

## **MEDSTAR HEALTH, INC.**

### Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(Dollars in millions)

**(h) *Interest in Net Assets of Foundation***

The Corporation recognizes its rights to assets held by recipient organizations, which accept cash or other financial assets from a donor and agree to use those assets on behalf of or transfer those assets, the return on investment of those assets, or both, to the Corporation. Changes in the Corporation's economic interests in these financially interrelated organizations are recognized in the consolidated statements of operations and changes in net assets as a component of changes in temporarily restricted net assets.

**(i) *Internal-Use Software***

The Corporation capitalizes the direct costs, including internal personnel costs, associated with the implementation of new information systems for internal use. The Corporation capitalized \$6.3 and \$1.1 during the years ended June 30, 2012 and 2011, respectively. Capitalized amounts are amortized over the estimated lives of the software, which is generally three to five years.

**(j) *Financing Costs***

Financing costs incurred in issuing bonds have been capitalized and included in other assets. These costs are being amortized over the estimated duration of the related debt using the effective interest method. Accumulated amortization totaled \$4.5 and \$4.6 at June 30, 2012 and 2011, respectively.

**(k) *Estimated Professional Liability Costs***

The provision for estimated self-insured professional liability claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. These estimates are based on actuarial analysis of historical trends, claims asserted and reported incidents. The receivables related to such claims are recorded at their net realizable value.

**(l) *Leases***

Lease arrangements, including assets under construction, are capitalized when such leases convey substantially all the risks and benefits incidental to ownership. Capital leases are amortized over either the lease term or the life of the related assets, depending upon available purchase options and lease renewal features. Amortization related to capital leases is included in the consolidated statements of operations within depreciation and amortization expense.

**(m) *Derivatives***

The Corporation utilizes derivative financial instruments to manage its interest rate risks associated with tax-exempt debt. The Corporation does not hold or issue derivative financial instruments for trading purposes. The derivative instruments are recorded on the balance sheet at their respective fair values. The Corporation's current derivative investments do not qualify for hedge accounting; therefore, the changes in fair value have been recognized in the accompanying consolidated statements of operations and changes in net assets as mark-to-market adjustments. The fair market value of the derivative instruments are included in other long-term liabilities in the accompanying consolidated balance sheets.

## **MEDSTAR HEALTH, INC.**

### Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(Dollars in millions)

**(n) Net Patient Service Revenue**

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments due to future audits, reviews and investigations. The differences between the estimated and actual amounts are recorded as part of net patient service revenue in future periods as the amounts become known, or as years are no longer subject to audit, review or investigation. Payment arrangements include prospectively determined rates per discharge, fee-for-service, discounted charges, and per diem payments. Hospital inpatient services, hospital outpatient services, the physician component of physician/managed care networks, and other patient services consists of revenue, which is recognized when the services are rendered based on billable charges. Other patient service revenue primarily consists of home care, long-term care and other nonhospital patient services.

Premium revenue consists of amounts received from the State of Maryland by the Corporation's managed care organization for providing medical services to subscribing participants, regardless of services actually performed. The managed care organization provides services primarily to enrolled Medicaid beneficiaries. This revenue is recognized ratably over the contractual period for the provision of services. Medical expenses of the managed care organization include a provision for incurred but unreported claims.

**(o) Charity Care**

The Corporation provides care to patients who meet certain criteria under its charity care policies without charge or at amounts less than established rates. Because the Corporation does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

**(p) Grants**

Federal grants are accounted for as either an exchange transaction or as a contribution based on terms and conditions of the grant. If the grant is accounted for as an exchange transaction, revenue is recognized as other operating revenue when earned. If the grant is accounted for as a contribution, the revenues are recognized as either other operating revenue, or as temporarily restricted contributions depending on the restrictions within the grant.

**(q) Contributions**

Unconditional promises to give cash and other assets to the Corporation are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statement of operations as net assets released from restrictions in other operating revenue. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

## **MEDSTAR HEALTH, INC.**

### Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(Dollars in millions)

**(r) *Meaningful Use Incentives***

Under certain provisions of the American Recovery and Reinvestment Act of 2009 (ARRA), federal incentive payments are available to hospitals, physicians and certain other professionals (Providers) when they adopt, implement or upgrade certified electronic health record (EHR) technology or become “meaningful users,” as defined under ARRA, of EHR technology in ways that demonstrate improved quality, safety and effectiveness of care. Incentive payments will be paid out over varying transitional schedules depending on the type of incentive (Medicare and Medicaid) and recipient (hospital or eligible provider). Eligible hospitals can attest for both Medicare and Medicaid incentives, while physicians must select to attest for either Medicare or Medicaid incentives. For Medicare incentives, eligible hospitals receive payments over four years while eligible physicians receive payments over five years. For Medicaid incentives, eligible hospitals receive payments based on the relevant State adopted payment structure (MD – four years, DC – to be determined) and physicians receive payments over six years.

The Corporation recognizes EHR incentives when it is reasonably assured that the Corporation will successfully demonstrate compliance with the meaningful use criteria. During the year ended June 30, 2012, certain hospitals and physicians satisfied the meaningful use criteria. As a result, the Corporation recognized \$6.6 of EHR incentives during fiscal year 2012 in other operating revenue.

**(s) *Income taxes***

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date. Any changes to the valuation allowance on the deferred tax asset are reflected in the year of the change. The Corporation accounts for uncertain tax positions in accordance with the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 740, *Income Taxes*.

**(t) *Excess of Revenue over Expenses***

The consolidated statements of operations and changes in net assets include a performance indicator, which is the excess of revenue over expenses. Changes in unrestricted net assets that are excluded from excess of revenue over expenses, include unrealized gains and losses on investments classified as other-than-trading securities, contributions of long-lived assets (including assets acquired using contributions that by donor restriction were to be used for the purpose of acquiring such assets), contributions from and distributions to noncontrolling interests, certain changes in accounting principle and defined benefit obligations in excess of recognized pension cost, among others.

**MEDSTAR HEALTH, INC.**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(Dollars in millions)

**(u) *Temporarily and Permanently Restricted Net Assets***

Temporarily restricted net assets are those whose use by the Corporation or individual operating units has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Corporation or individual operating units in perpetuity.

**(v) *Fair Value of Financial Instruments***

The following methods and assumptions were used to estimate the fair value of financial instruments:

*Cash and cash equivalents, receivables, other current assets, other assets, current liabilities and long-term liabilities:* The carrying amount reported in the consolidated balance sheets for each of these assets and liabilities approximates their fair value.

The fair value of investments, assets whose use is limited or restricted and the interest rate swap is discussed in note 3. The fair value of long term debt is discussed in note 6.

**(w) *Reclassifications***

Certain prior year amounts have been reclassified to conform with current period presentation, the effect of which is not material.

**(x) *New Accounting Pronouncements***

In July 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-07, *Health Care Entities (Topic 954), Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities (ASU 2011-07)*, which requires a health care entity to change the presentation of their statement of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). Additionally, enhanced disclosures about an entity's policies for recognizing revenue, assessing bad debts, as well as qualitative and quantitative information about changes in the allowance for doubtful accounts are required. The adoption of ASU 2011-07 is effective for the Corporation beginning July 1, 2012 and is not expected to have a material impact on the Corporation's consolidated financial statements.

In August 2010, the FASB issued ASU No. 2010-24, *Health Care Entities (Topic 954), Presentation of Insurance Claims and Related Insurance Recoveries (ASU 2010-24)*, which clarified that a health care entity should not net insurance recoveries against a related claim liability. Additionally, the amount of the claim liability should be determined without consideration of insurance recoveries. The Corporation adopted ASU 2010-24 on July 1, 2011. The adoption of this ASU did not have an impact on the Corporation's consolidated financial statements.

In August 2010, the FASB issued ASU No. 2010-23, *Health Care Entities (Topic 954), Measuring Charity Care for Disclosure (ASU 2010-23)*. ASU 2010-23 is intended to reduce the diversity in

**MEDSTAR HEALTH, INC.**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(Dollars in millions)

practice regarding the measurement basis used in the disclosure of charity care. ASU 2010-23 requires that cost be used as the measurement basis for charity care disclosure purposes and that cost be identified as the direct and indirect cost of providing the charity care, and requires disclosure of the method used to identify or determine such costs. The Corporation adopted the provisions of ASU 2010-23 on July 1, 2011 (see note 15). Since the Corporation does not recognize revenue when charity care is provided, adoption of this guidance did not have an impact on the consolidated financial statements.

**(2) Investments and Assets Whose Use Is Limited or Restricted**

Investments and assets whose use is limited or restricted as of June 30, 2012 and 2011, at fair value or under the equity method of accounting in the case of alternative investments, consist of the following:

	<b>2012</b>	<b>2011</b>
Collateralized guaranteed investment contract and cash	\$ 89.4	77.1
Fixed income securities and funds	336.4	314.3
Equity securities	383.5	389.0
Alternative investments:		
Commingled equity funds	67.5	95.2
Inflation hedging equity, commodity, fixed income fund	57.0	64.9
Hedge fund of funds and private equity	137.0	108.4
Total investments and assets whose use is limited or restricted	1,070.8	1,048.9
Less short-term investments and assets whose use is limited or restricted	(82.4)	(54.7)
Long-term investments and assets whose use is limited or restricted	\$ 988.4	994.2

Assets whose use is limited or restricted as of June 30, 2012 and 2011, included in the table above, consist of the following:

	<b>2012</b>	<b>2011</b>
Funds held by trustees	\$ 13.0	17.0
Self-insurance funds	186.1	163.1
Funds restricted by donors for specific purposes and endowment	62.2	63.8
Funds designated by Board and Management	178.2	183.2
	439.5	427.1
Less assets required for current obligations	(63.4)	(36.7)
	\$ 376.1	390.4



**MEDSTAR HEALTH, INC.**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(Dollars in millions)

Investment income and realized and unrealized (losses) gains for assets whose use is limited, cash equivalents and investments are comprised of the following for the years ending June 30, 2012 and 2011:

	2012	2011
Other operating revenue:		
Investment income	\$ 3.8	6.5
Nonoperating gains (losses):		
Investment income	14.6	20.3
Net realized (losses) gains on sale of investments	(9.7)	9.1
Unrealized (losses) gains on trading investments	(13.1)	66.5
Equity interest in alternative investments	(15.4)	31.1
	(23.6)	127.0
Other changes in net assets:		
Realized net gains on temporarily and permanently restricted net assets	2.3	7.3
Changes in unrealized (losses) gains on temporarily and permanently restricted net assets	(2.7)	5.6
Total investment return	\$ (20.2)	146.4

**(3) Fair Value of Financial Instruments**

The Corporation follows ASC Topic 820, *Fair Value Measurement* which provides for the following:

- Defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, and establishes a framework for measuring fair value;
- Establishes a three-level hierarchy for fair value measurement;
- Requires consideration of the Corporation's nonperformance risk when valuing liabilities; and
- Expands disclosures about instruments measured at fair value.

The three-level valuation hierarchy for fair value measurements is based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Corporation's market assumptions. The three level valuation hierarchy is defined as follows:

- Level 1 – Quoted prices for identical instruments in active markets;
- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar investments in markets that are not active; and model derived valuations whose significant inputs are observable; and
- Level 3 – Instruments whose significant inputs are unobservable.

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The Corporation has incorporated an Investment Policy Statement (IPS) into the investment program. The IPS, which has been formally adopted by the Corporation's Board of Directors, contains numerous standards designed to ensure adequate diversification by asset class and geography. The IPS also limits all investments by manager and position size, and limits fixed income position size based on credit ratings, which serves to further mitigate the risks associated with the investment program. At June 30, 2012 and 2011, management believes that all investments were being managed in a manner consistent with the IPS.

The table below presents the Corporation's investable assets and liabilities as of June 30, 2012, aggregated by the three level valuation hierarchy:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>Assets:</b>				
Cash and cash equivalents	\$ 658.0	—	—	658.0
U.S. treasury bonds	48.6	—	—	48.6
U.S. agency mortgage backed securities	85.9	—	—	85.9
Corporate bonds	—	84.1	—	84.1
Fixed income mutual funds	1.3	79.3	—	80.6
All other fixed income securities	3.8	33.4	—	37.2
Equity mutual funds & ETF's	68.2	—	—	68.2
Common stocks	315.3	—	—	315.3
<b>Total assets</b>	<b>\$ 1,181.1</b>	<b>196.8</b>	<b>—</b>	<b>1,377.9</b>
<b>Liabilities:</b>				
Interest rate swap	\$ —	23.2	—	23.2
<b>Total liabilities</b>	<b>\$ —</b>	<b>23.2</b>	<b>—</b>	<b>23.2</b>

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The table below presents the Corporation's investable assets and liabilities as of June 30, 2011, aggregated by the three level valuation hierarchy:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>Assets:</b>				
Cash and cash equivalents	\$ 575.7	—	—	575.7
U.S. treasury bonds	55.3	—	—	55.3
U.S. agency mortgage backed securities	75.9	—	—	75.9
Corporate bonds	—	73.9	—	73.9
Fixed income mutual funds	1.0	70.4	—	71.4
All other fixed income securities	—	37.8	—	37.8
Equity mutual funds & ETF's	106.4	—	—	106.4
Common stocks	282.6	—	—	282.6
Total assets	<u>\$ 1,096.9</u>	<u>182.1</u>	<u>—</u>	<u>1,279.0</u>
<b>Liabilities:</b>				
Interest rate swap	\$ —	15.4	—	15.4
Total liabilities	<u>\$ —</u>	<u>15.4</u>	<u>—</u>	<u>15.4</u>

See note 1(e) for information on investments of the Corporation, which are treated under the equity method and not reported above.

For the years ended June 30, 2012 and 2011, there were no significant transfers into or out of Levels 1, 2 or 3.

## MEDSTAR HEALTH, INC.

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#### (4) Property and Equipment

Property and equipment as of June 30, 2012 and 2011 is as follows:

	<u>2012</u>	<u>2011</u>
Land	\$ 59.6	60.8
Buildings and improvements	1,167.2	1,131.9
Equipment	1,505.7	1,464.1
Equipment under capital leases	—	1.5
	<u>2,732.5</u>	<u>2,658.3</u>
Less accumulated depreciation and amortization	<u>(1,784.6)</u>	<u>(1,689.5)</u>
	947.9	968.8
Construction-in-progress	<u>89.7</u>	<u>63.0</u>
	<u>\$ 1,037.6</u>	<u>1,031.8</u>

Construction-in-progress includes a variety of ongoing capital projects at the Corporation as of June 30, 2012 and 2011. Depreciation and amortization expense related to property and equipment amounted to \$155.5 and \$152.8 for the years ended June 30, 2012 and 2011, respectively.

#### (5) Other Assets

Other assets as of June 30, 2012 and 2011 consist of the following:

	<u>2012</u>	<u>2011</u>
Deferred financing costs, net	\$ 12.5	13.3
Investments in unconsolidated entities	15.7	16.0
Reinsurance receivables	40.3	37.6
Goodwill, net	21.2	7.6
Deferred tax asset	26.1	21.4
Other assets	<u>34.7</u>	<u>39.2</u>
	<u>\$ 150.5</u>	<u>135.1</u>

The Corporation has investments in other healthcare related organizations that are accounted for under the equity method that total \$15.7 and \$16.0 at June 30, 2012 and 2011, respectively. Under the equity method, original investments are recorded at cost and adjusted by the Corporation's share of the undistributed earnings or losses of these organizations. The related ownership interest in these organizations ranges from 8% to 50%. The Corporation's share of earnings in these organizations was \$4.1 and \$5.5 for the years ended June 30, 2012 and 2011, respectively, and are recognized in other operating revenue in the consolidated statements of operations and changes in net assets. Certain other nonconsolidated entities are recorded under the cost method.

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Goodwill represents the excess of the cost to acquire businesses over the estimated fair market value of the net tangible and identifiable intangible assets acquired. The Corporation recognized amortization expense of \$1.0 and \$0.2 for the years ended June 30, 2012 and 2011, respectively, related to identifiable intangible assets. In accordance with guidance issued by FASB, the Corporation annually evaluates goodwill for impairment based upon a earnings multiple factor and operating income for each reporting unit. At July 1, 2011 and June 30, 2012, the Corporation had one reporting unit, which included all subsidiaries of the Corporation. No impairment was recognized for the years ended June 30, 2012 or 2011.

In connection with certain definitive agreements between the Corporation and Georgetown University as described in note 17, the Corporation recognized approximately \$10.0 of goodwill.

**(6) Debt**

At June 30, 2012 and 2011, the Corporation's outstanding borrowings include the following:

	<b>2012</b>	<b>2011</b>
Maryland Health and Higher Educational Facilities Authority Revenue Bonds:		
4.25% – 5.75% Serial bonds (Series 2004, due 2009 – 2025)	\$ 29.7	33.5
5.375% Term bonds (Series 2004, due 2024)	49.7	49.7
5.50% Term bonds (Series 2004, due 2033)	80.1	80.1
4.25% – 5.25% Serial bonds (Series 1998A, due 2008 – 2012)	4.5	8.8
4.75% – 5.25% Term bonds (Series 1998A, due 2018, 2028, and 2038)	112.8	146.2
4.00% – 5.25% Serial bonds (Series 1998B, due 2013 – 2015)	—	14.8
4.75% – 5.25% Term bonds (Series 1998B, due 2028 and 2038)	77.9	88.5
4.75% – 5.25% Term bonds (Series 2007, due 2042 and 2046)	145.0	145.0
2.00% – 5.00% Serial bonds (Series 2011, due 2012 – 2023)	53.9	—
5.00% Term bonds (Series 2011, due 2031)	5.6	—
5.00% Term bonds (Series 2011, due 2041)	35.4	—
2.19% Direct Purchase (Series 2012, due 2017 – 2022)	38.6	—
0.08% – 0.40% MedStar St. Mary's Hospital Variable Rate bonds (Series 2009, due 2010 – 2039)	—	15.5
Plus unamortized net premium	9.3	5.8
	<b>642.5</b>	<b>587.9</b>

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	<u>2012</u>	<u>2011</u>
District of Columbia Hospital Revenue Bonds:		
Multimodal Revenue bonds:		
0.14% – 0.21% at June 30, 2012 Serial bonds (Series 1998A due 2008-2038) (and 0.04% – 0.15% at June 30, 2011)	\$ 131.7	134.4
2.75% – 5.00% Serial bonds (Series 1998B, due 2008 – 2019)	12.3	13.5
5.00% Term bonds (Series 1998B, due 2028 and 2038)	54.1	54.1
2.75% – 5.00% Serial bonds (Series 1998C, due 2008 – 2019)	12.3	13.5
5.00% – 5.50% Term bonds (Series 1998C, due 2028 and 2038)	54.1	54.1
Less unamortized net discount	<u>(1.2)</u>	<u>(1.0)</u>
	<u>263.3</u>	<u>268.6</u>
County Commissioners of St. Mary’s County General Obligation Hospital Bonds of 2002: (Rates ranging between 3.58% – 3.78% due, 2005 – 2022)	—	15.0
MedStar St. Mary’s Hospital notes payable and other	2.6	4.0
Other:		
Notes payable to financial institutions or State Agencies under mortgages (floating rates ranging between 0.5% – 8.2%) and other	12.4	14.0
Line of credit due November 2013 (0.25% – 0.95% at June 30, 2012 and 0.25% – 0.90% at June 30, 2011)	<u>107.8</u>	<u>155.0</u>
	<u>122.8</u>	<u>188.0</u>
Total debt	1,028.6	1,044.5
Less current portion of long-term debt	<u>(18.5)</u>	<u>(37.0)</u>
Long-term debt, net	<u>\$ 1,010.1</u>	<u>1,007.5</u>

Scheduled maturities on borrowings, for the next five fiscal years and thereafter are as follows:

2013	\$ 18.5
2014	127.1
2015	18.6
2016	19.2
2017	19.2
Thereafter	<u>817.9</u>
Total	<u>\$ 1,020.5</u>

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The fair value of outstanding tax exempt publicly traded bonds is estimated to be \$965.2 and \$865.4 as of June 30, 2012 and 2011, respectively. The fair value of other long-term debt approximates its carrying value.

In December 1998, the Maryland Health and Higher Education Facilities Authority (MHHEFA) and the District of Columbia (District) issued bonds (Series 1998 Bonds) on behalf of the Corporation. Bond proceeds of approximately \$588.6 were loaned to the Corporation under separate loan agreements with MHHEFA and the District upon execution of obligations pursuant to the Master Trust Indenture. The District issued \$300.0 of Multimodal Revenue Bonds, including \$150.0 Series 1998A (\$21.1 repaid through August 2012), \$75.0 Series 1998B (\$9.9 repaid through August 2012), and \$75.0 Series 1998C (\$9.9 repaid through August 2012).

The District Series 1998A bonds, which consist of three tranches totaling \$128.9 at August 2012, were converted to Variable Rate Demand Obligations backed by bank letters of credit in May 2008 and the municipal bond insurance policy was terminated. The Series 1998A Tranche I bonds which remained outstanding in August 2012 consisted of approximately \$43.0 bonds trading in a daily mode backed by a letter of credit issued by Wells Fargo Bank, National Association (formerly Wachovia Bank, National Association) and remarketed by J.P. Morgan Securities Inc. The letter of credit was renewed in fiscal 2011 and now expires in May 2014. In the event of a failed remarketing, the Tranche I bonds would be tendered to the bank and repaid over a four-year period, beginning 367 days following the date of the failed remarketing. The Series 1998A Tranche II bonds totaled \$43.0 in August 2012. These bonds trade in a weekly mode and are remarketed by Citigroup Global Markets Inc. The letter of credit backing these bonds was replaced in fiscal 2012 by a new letter of credit issued by JPMorgan Chase Bank, N.A. and expires in May 2015. In the event of a failed remarketing, the Tranche II bonds would be tendered to the bank and repaid over a four-year period, beginning 367 days following the failed remarketing. The Series 1998A Tranche III bonds totaled \$43.0 in August 2012. These bonds trade in a weekly mode and are remarketed by Citigroup Global Markets Inc. The letter of credit backing these bonds was replaced in fiscal 2012 by a new letter of credit issued by PNC Bank, National Association. The term of the letter of credit is five years, expiring in May 2017. In the event of a failed remarketing, the Tranche III bonds would be tendered to the bank and repaid over a four-year period, beginning 367 days following the failed remarketing. No portion of the Series 1998A bonds has been put at June 30, 2012 and 2011, respectively. The \$65.1 Series 1998B and \$65.1 Series 1998C bonds (as of August 2012) were converted to a fixed rate in May 2008 and remain insured by Assured Guaranty, Ltd. (Assured; formerly Financial Security Assurance, Inc.). The reimbursement obligation with respect to the letters of credit are evidenced and secured by obligations issued by the Corporation under the Master Trust Indenture.

MHHEFA issued \$283.5 of Revenue Bonds, including the \$166.6 Series 1998A (\$112.8 outstanding after August 2012) and \$116.9 Series 1998B (\$77.9 outstanding after August 2012). All Series 1998 MHHEFA bonds were issued at fixed rates. Principal and interest under the Series 1998 MHHEFA bonds are insured under municipal insurance policies with Assured and Ambac. Of the Series 1998 MHHEFA bonds, \$20.2 was refinanced in November 2011 in conjunction with the MHHEFA Series 2011 financing described below.

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Related to the District borrowings, the Corporation entered into an interest rate swap with Wells Fargo Bank, National Association in a notional amount totaling \$150.0 (reduced to \$109.1 at August 2012). The swap agreement expires in fiscal year 2027. The interest rate swap is part of a comprehensive and long-term capital structure strategy. The purpose of the swap is to mitigate the effect of potential interest rate volatility and minimize the variability of the Corporation's average cost of capital. Under the terms of the swap, the Corporation pays a fixed rate and receives a variable rate. Collateral is only required to be posted under the swap in the event that the Corporation's credit ratings are downgraded by two rating agencies below the BBB – or Baa2 – level. To date, no collateral postings have been required. At June 30, 2012 and 2011, the variable interest rate under these agreements was 0.16% and 0.12%, respectively. The fixed rate was 3.69% as of June 30, 2012 and 2011. The variable rates are capped at 14.0%. The fair value of the interest rate swap at June 30, 2012 and 2011 was \$23.2 and \$15.4, respectively, and is included in other long-term liabilities. The change in fair value of the swap is reported in nonoperating gains (losses) in the statements of operations and changes in net assets.

In February 2004, MHHEFA issued \$170.3 in bonds (Series 2004 Bonds) on behalf of the Corporation. The proceeds of the Series 2004 Bonds were loaned to the Corporation pursuant to a loan agreement with MHHEFA upon execution of an obligation pursuant to the Master Trust Indenture. The Series 2004 Bonds were issued as \$40.5 serial bonds maturing 2009 through 2025 (\$14.8 repaid through August 2012), \$49.7 term bonds maturing 2024, and \$80.1 term bonds maturing 2033. Such Bonds were issued at fixed rates. Series 2004 Bonds maturing on or after August 2015 are subject to redemption or purchase at the option of the Corporation prior to maturity beginning in 2014.

In January 2007, MHHEFA issued \$145.0 in bonds (Series 2007 Bonds) on behalf of the Corporation. The Series 2007 Bonds were issued at a net premium of \$3.6, resulting in total proceeds of \$148.6. The proceeds of the Series 2007 Bonds were loaned to the Corporation pursuant to a loan agreement with MHHEFA upon execution of an obligation pursuant to the Master Trust Indenture. The Series 2007 Bonds were issued as \$56.0 term bonds maturing 2042 and \$89.0 term bonds maturing 2046. Such Bonds were issued at fixed rates. Series 2007 Bonds maturing on or after May 2042 are subject to redemption or purchase at the option of the Corporation prior to maturity beginning in 2016.

In November 2011, MHHEFA issued \$94.9 in bonds (Series 2011 Bonds) on behalf of the Corporation. The proceeds of the Series 2011 Bonds were loaned to the Corporation pursuant to a loan agreement with MHHEFA upon execution of an obligation pursuant to the Master Trust Indenture. The Series 2011 Bonds were issued as \$53.9 Serial Bonds maturing 2012 through 2023, \$5.6 term bonds maturing 2031, and \$35.4 term bonds maturing 2041. The Series 2011 Bonds maturing on or after August 2022 are subject to redemption or purchase at the option of the Corporation prior to maturity beginning in 2021. The Series 2011 Bonds were issued at fixed rates. The proceeds from the transaction were used to refund \$20.2 of the Series 1998 A&B bonds, to refund debt outstanding on the Corporation's Revolving Credit Facility, and to refund certain debt associated with MedStar St. Mary's Hospital.

In June 2012, the Corporation entered into a \$38.6 MHHEFA Direct Purchase financing transaction with JP Morgan Chase Bank, N.A. (the Series 2012 Bond). The proceeds from the transaction were used to redeem certain outstanding MHHEFA Series 1998 A bonds that were due to mature in 2018 as well as a portion of the outstanding MHHEFA Series 1998 A&B bonds due to mature in 2028. The repayment of the



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Series 2012 Bond is evidenced by an obligation issued under the Master Trust Indenture. The term of the Series 2012 Bond is ten years and the repayment terms approximate the previous repayment terms of the Series 1998 bonds that were refunded. Covenants, conditions, and security for the Series 2012 Bond is similar to the revolving credit agreement.

The Corporation, which is currently the sole member of an “obligated group” as defined in the Master Trust Indenture, is bound by the provisions of the Master Trust Indenture for payment of any outstanding obligations under existing loan agreements. All of the hospitals and certain other affiliates (the guarantors) of the Corporation are parties to a guaranty agreement pursuant to which they jointly and severally guaranty the payment and performance of the obligations under the Master Trust Indenture. The obligations of the guarantors under the Guaranty Agreement are collateralized by deeds of trust granted by the hospitals. Under the Master Trust Indenture and the deeds of trust, as collateral for the payments due thereunder, the Corporation and its hospital affiliates, have granted a security interest in their revenues subject to permitted encumbrances.

Under the Master Trust Indenture, the Corporation is required to maintain, among other covenants, a maximum annual debt service coverage ratio of not less than 1.10 to 1.0. Under the loan agreements relating to the Series 1998 Bonds, the Corporation is required to maintain a historical debt service coverage ratio of not less than 2.0 to 1.0 and to maintain at least 65 days cash on hand. In the event the Corporation does not meet either of these requirements, it is required to fund a trustee-held debt service reserve fund securing the Series 1998 Bonds. The amount to be deposited shall equal the lesser of: 10% of the principal amount of such outstanding bonds, or the largest annual debt service with respect to such bonds in any future year, or 125% of the average annual debt service of future years. At June 30, 2012 and 2011, there were no funds required to be held in the debt service reserve fund for the Series 1998 Bonds.

The Corporation maintains a \$250.0 revolving credit agreement provided by a group of banks. The three-year facility expires November 2013. The facility is evidenced by an obligation issued under the Master Trust Indenture. The outstanding balance on the facility was \$107.8 at June 30, 2012 and \$155.0 at June 30, 2011. At June 30, 2012 and June 30, 2011, the outstanding balance being held in operating cash in order to maximize the Corporation’s liquidity was \$47.8. The facility includes certain covenants, including a requirement to maintain Days Cash on Hand of 70 days, measured semi-annually at each June 30 and December 31, and a Debt Service Coverage ratio of 1.25, measured quarterly on a rolling four quarters basis. In addition, the Corporation is required to maintain a minimum credit rating of Baa2 from Moody’s Investor’s Service, and BBB from Standard & Poor’s and Fitch Ratings.

In addition, the Corporation maintains a \$30.0 letter of credit facility, provided by a single lender, which is also evidenced by an obligation issued under the Master Trust Indenture. This facility is principally used to securitize certain regulatory obligations under various insurance programs. This three-year facility, which has terms and conditions similar to the revolving credit agreement, expires in November 2013. However, the standby letters of credit issued under the facility can be canceled at the bank’s option each year. At June 30, 2012 and 2011, standby letters of credit issued pursuant to the facility were \$18.0 and \$16.8, respectively. However, no amounts have been drawn by the beneficiaries under the standby letters of credit.

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MedStar St. Mary's Hospital had certain debt outstanding, including 2002 St. Mary's County General Obligation bonds with an outstanding balance of \$15.0 at August 2011 and Series 2009 MHHEFA bonds with an outstanding balance of \$15.4 at August 2011. The bonds were secured by a mortgage on the real property of MedStar St. Mary's Hospital and a pledge of MedStar St. Mary's Hospital's revenues. Under terms of the financing documents, MedStar St. Mary's Hospital was required to maintain days cash on hand of 85 days, and to maintain a historical debt service coverage ratio in excess of 1.10. MedStar St. Mary's Hospital was also subject to certain additional covenants and tests on an ongoing basis. The 2009 bonds traded in a weekly mode backed by a letter of credit issued by Bank of America, N.A. and remarketed by Merrill Lynch, Pierce, Fenner & Smith, Incorporated. This debt was retired in conjunction with the November 2011 MHHEFA Series 2011 bonds discussed above.

#### (7) Retirement Plans

The Corporation has two qualified defined benefit pension plans (MedStar Health, Inc. Pension Equity Plan (PEP) and MedStar Health, Inc. Cash Balance Retirement Plan (CBRP)) covering substantially all full-time employees hired before 2005, and a supplemental executive pension plan (SEPP) for certain executive management employees. MedStar St. Mary's Hospital also has a defined benefit plan that substantially covers all employees of MedStar St. Mary's Hospital.

Benefits under the plans are substantially based on years of service and the employees' career earnings. The Corporation contributes to the plans based on actuarially determined amounts necessary to provide assets sufficient to meet benefits to be paid to plan participants and to meet the minimum funding requirements of the Employee Retirement Income Security Act of 1974, as amended by the Pension Protection Act of 2006, and Internal Revenue Service regulations. Effective July 1, 2000, employees of the Transferred Businesses (see note 17) became participants in one of the Corporation's pension plans and are reflected in the pension information provided below.

The Corporation's investment policies are established by the MedStar Health, Inc.'s Investment Committee, which is comprised of members of the Board of Directors, other community leaders, and management. Among its responsibilities, the Investment Committee is charged with establishing and reviewing asset allocation strategies, monitoring investment manager performance, and making decisions to retain and terminate investment managers. Assets of each of the Corporation's pension plans are managed in a similar fashion by the same group of investment managers. The Corporation has incorporated an Investment Policy Statement (IPS) into the investment program. The IPS, which has been formally adopted by the Corporation's Board of Directors, contains numerous standards designed to ensure adequate diversification by asset class and geography. The IPS also limits all investments by manager and position size, and limits fixed income position size based on credit ratings, which serves to further mitigate the risks associated with the investment program. At June 30, 2012 and 2011, management believes that all investments were being managed in a manner consistent with the IPS.

The Investment Committee has adopted certain target ranges for various asset classes within the pension portfolio. At June 30, 2012 and 2011, these targets included the investment of approximately 49% of the portfolio in publicly traded equities, 25% in fixed income securities, 15% in hedge funds and private equity, 10% in inflation hedging strategies (including real estate), and 1% in cash. Actual asset allocations fluctuate depending upon gains and losses within asset classes over periods of time, the timing of plan

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contributions and distributions, and rebalancing decisions. Due to these fluctuations, actual asset allocations could exceed these levels over certain periods in time.

The following table illustrates the actual allocations at June 30:

	<b>Actual allocation June 30, 2012</b>	<b>Actual allocation June 30, 2011</b>
Publicly traded equities – domestic	29%	36%
Publicly traded equities – international	11	8
Fixed income securities	24	23
Alternative investments:		
Commingled equity funds	7	10
Inflation hedging equity, commodity, fixed income fund	6	6
Hedge funds	11	8
Private equities	2	2
Cash	10	7
Total	<u>100%</u>	<u>100%</u>

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The table below presents the Corporation's pension plans' investable assets as of June 30, 2012 aggregated by the three level valuation hierarchy:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Cash and cash equivalents	\$ 77.7	—	—	77.7
U.S. treasury bonds	37.4	—	—	37.4
U.S. agency mortgage backed securities	31.8	—	—	31.8
Corporate bonds	—	41.0	—	41.0
Fixed income mutual funds	—	61.5	—	61.5
All other fixed income securities	0.1	16.8	—	16.9
Equity mutual funds and ETF's	56.6	—	—	56.6
Common stocks	254.0	—	—	254.0
Alternative investments:				
Commingled equity funds	—	50.4	—	50.4
Inflation hedging equity, commodity, fixed income fund	—	47.0	—	47.0
Private equity	—	—	17.1	17.1
Hedge funds	—	—	82.4	82.4
Total assets	<u>\$ 457.6</u>	<u>216.7</u>	<u>99.5</u>	<u>773.8</u>

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The table below presents the Corporation's pension plans' investable assets as of June 30, 2011 aggregated by the three level valuation hierarchy:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Cash and cash equivalents	\$ 50.1	—	—	50.1
U.S. treasury bonds	44.6	—	—	44.6
U.S. agency mortgage backed securities	23.1	—	—	23.1
Corporate bonds	—	30.6	—	30.6
Fixed income mutual funds	—	49.9	—	49.9
All other fixed income securities	—	16.6	—	16.6
Equity mutual funds and ETF's	72.0	—	—	72.0
Common stocks	249.1	—	—	249.1
Alternative investments:				
Commingled equity funds	—	74.4	—	74.4
Inflation hedging equity, commodity, fixed income fund	—	39.2	—	39.2
Private equity	—	—	15.1	15.1
Hedge funds	—	—	61.1	61.1
Total assets	<u>\$ 438.9</u>	<u>210.7</u>	<u>76.2</u>	<u>725.8</u>

For the years ended June 30, 2012 and 2011, there were no significant transfers between Levels 1, 2 or 3.

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Changes to the fair values based on the Level 3 inputs are summarized as follows:

	<u>Private equity</u>	<u>Hedge funds</u>	<u>Total</u>
Balance as of June 30, 2010	\$ 14.2	52.7	66.9
Additions:			
Contributions/purchases	0.5	4.6	5.1
Disbursements:			
Withdrawals/sales	(1.0)	(0.7)	(1.7)
Net change in value	<u>1.4</u>	<u>4.5</u>	<u>5.9</u>
Balance as of June 30, 2011	15.1	61.1	76.2
Additions:			
Contributions/purchases	1.8	23.4	25.2
Disbursements:			
Withdrawals/sales	(2.6)	(0.4)	(3.0)
Net change in value	<u>2.8</u>	<u>(1.7)</u>	<u>1.1</u>
Balance as of June 30, 2012	\$ <u>17.1</u>	<u>82.4</u>	<u>99.5</u>

The following summarizes redemption terms for the hedge fund-of-funds vehicles held as of June 30, 2012:

	<u>Fund 1</u>	<u>Fund 2</u>	<u>Fund 3</u>
Redemption timing:			
Redemption frequency	Quarterly	Quarterly	Quarterly
Required notice	70 Days	90 Days	65 Days
Audit reserve:			
Percentage held back for audit reserve	10%	10%	10%
Gates:			
Potential gate holdback	—	—	—
Potential gate release timeframe			

Investments in hedge fund-of-funds are typically carried at estimated fair value. Fair value is based on the Net Asset Value (NAV) of the shares in each investment company or partnership. Such investment companies or partnerships mark-to-market or mark-to-fair value the underlying assets and liabilities in accordance with U.S. generally accepted accounting principles. Realized and unrealized gains and losses of the investment companies and partnerships are included in their respective operations in the current year. Changes in unrealized gains or losses on investments, including those for which partial liquidations were effected in the course of the year, are calculated as the difference between the NAV of the investment at year-end less the NAV of the investment at the beginning of the year, as adjusted for contributions and

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redemptions made during the year and certain lock-up provisions. Generally, no dividends or other distributions are paid.

The following summarizes the status of contributions to the private equity fund-of-funds vehicles held as of June 30, 2012:

	<u>Total commitment</u>	<u>Percentage of commitment contributed</u>	<u>Percentage of commitment remaining</u>
Fund 1	\$ 9.0	88.6%	11.4%
Fund 2	8.5	92.1	7.9
Fund 3	<u>8.5</u>	66.0	34.0
Total	<u>\$ 26.0</u>		

Investments in limited partnership interests are carried at fair value as determined by the General Partner in the absence of readily ascertainable market values. The fair value of limited partnership interests is generally based on fair value capital balances reported by the underlying partnerships, subject to management review and adjustment. Security values of companies traded on exchanges, or quoted on NASDAQ, are based upon the last reported sales price on the valuation date. Security values of companies traded over the counter, but not quoted on NASDAQ, and securities for which no sale occurred on the valuation date are based upon the last quoted bid price. The value of any security for which a market quotation is not readily available may be its cost, provided however, that the General Partner adjusts such cost value to reflect any bona fide third party transactions in such a security between knowledgeable investors, of which the General Partner has knowledge. In the absence of any such third party transactions, the General Partner may use other information to develop a good faith determination of value. Examples include, but are not limited to, discounted cash flow models, absolute value models, and price multiple models. Inputs for these models may include, but are not limited to, financial statement information, discount rates, and salvage value assumptions.

The valuation of both marketable and nonmarketable securities may include discounts to reflect a lack of liquidity or extraordinary risks, which may be associated with the investment. Determination of fair value is performed on a quarterly basis by the General Partner. Because of the inherent uncertainty of valuation, the determined values may differ significantly from the values that would have been used had a ready market for those investments existed.

The Corporation has established a long-term investment return target of 8.25% for PEP and CBRP in 2012 and 2011. These assumptions are based on historical returns achieved in the investment portfolios over the last ten years and represent the return that can reasonably be expected to be generated on a similarly structured portfolio in the future.

The Corporation recognizes the funded status of defined benefit pension plans in the balance sheet and the recognition in unrestricted net assets of unrecognized gains or losses, prior service costs or credits and transition assets or obligations. The funded status is measured as the difference between the fair value of

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the plan's assets and the projected benefit obligation of the plan. The measurement date for the plans is June 30.

In March 2011, the Corporation terminated the SEPP plan effective December 31, 2011. The freeze constitutes a curtailment and as such, the Corporation remeasured the lump sum value of participants' benefits as of March 31, 2011. The remeasurement and curtailment accounting resulted in an increase to net assets of approximately \$3.4. Participants were paid their accrued benefit, in the amount of \$7.6, in March 2012.

In May 2011, the National Nurses United employees at the MedStar Washington Hospital Center entered into a new collective bargaining agreement whereby they agreed to a freeze of their benefit accruals in the CBRP. The freeze was effective December 31, 2010. Effective January 1, 2011, National Nurses United employees earn all future benefits through the Corporation's defined contribution retirement savings plan. The freeze constitutes a curtailment and as such, the Corporation remeasured the plans' assets and projected benefit obligations at May 1, 2011. The remeasurement and curtailment accounting resulted in a reduction to net assets of approximately \$2.2.

In November 2011, the collective bargaining agreement for the Service Employees International Union (SEIU) Local 722 was reached and communicated to employees. As part of the new agreement, the SEIU employees' pension benefit accruals were frozen as of December 31, 2011. As such, the CBRP was remeasured at November 30, 2011, the month in which the agreement was finalized and communicated. As a result of the remeasurement, the Corporation recognized a \$39.7 reduction in net assets, which is included in the change in funded status of defined benefit plans in the consolidated statements of operations and changes in net assets.

By letter dated March 12, 2012, the IRS notified the Corporation that it has selected the retirement plans for a routine examination. The examination is expected to cover the plan year ended December 31, 2010.



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The following are deferred pension costs which have not yet been recognized in periodic pension expense but instead are accrued in unrestricted net assets, as of June 30, 2012 and 2011. Unrecognized actuarial losses represent unexpected changes in the projected benefit obligation and plan assets over time, primarily due to changes in assumed discount rates and investment experience. Unrecognized prior service cost is the impact of changes in plan benefits applied retrospectively to employee service previously rendered. Deferred pension costs are amortized into annual pension expense over the expected future lifetime for active employees with frozen benefits.

	<b>Amounts in unrestricted net assets to be recognized during the next fiscal year</b>	<b>Amounts recognized in unrestricted net assets at June 30, 2012</b>	<b>Amounts recognized in unrestricted net assets at June 30, 2011</b>
Net prior service cost	\$ —	—	(0.1)
Net actuarial loss	16.7	654.2	403.5
Total	\$ 16.7	654.2	403.4

The following table sets forth the plans' funded status and amounts recognized in the accompanying consolidated financial statements as of June 30, 2012 and 2011:

	<b>2012</b>	<b>2011</b>
<b>Change in benefit obligation:</b>		
Benefit obligation at beginning of year	\$ 1,039.7	982.6
Service cost	1.4	7.2
Interest cost	58.7	56.3
Participants contributions	0.2	0.9
Actuarial loss	184.9	29.0
Benefits paid	(40.1)	(26.2)
Curtailments	(0.9)	(10.1)
Settlements	0.2	—
Benefit obligation at end of year	1,244.1	1,039.7
<b>Change in plan assets:</b>		
Plan assets at fair value at beginning of year	725.8	581.3
Actual return on plan assets	(22.2)	101.4
Company contributions	110.1	68.4
Plan participants' contributions	0.2	0.9
Benefits paid	(40.1)	(26.2)
Plan assets at fair value at end of year	773.8	725.8
Funded status/net amount recognized	\$ (470.3)	(313.9)

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The amounts recognized in the consolidated financial statements consist of the following at June 30:

	<u>2012</u>	<u>2011</u>
Pension assets (included in other assets)	\$ —	1.6
Pension current liabilities (included in other current liabilities)	—	7.6
Pension liabilities	470.3	307.6

Expected contributions for the defined benefit plans are \$70.4 for the year ended June 30, 2013.

The accumulated benefit obligation is \$1,244.1 and \$1,013.9 at June 30, 2012 and 2011, respectively.

Expected fiscal year benefit payments for all defined benefit plans is as follows:

2013	\$ 38.4
2014	52.8
2015	54.8
2016	56.1
2017	59.9
2018-2022	<u>347.7</u>
Total	<u>\$ 609.7</u>

Net periodic pension expense for the years ended June 30, 2012 and 2011 is as follows:

	<u>2012</u>	<u>2011</u>
Service cost – benefits earned during the year	\$ 1.4	7.2
Interest cost on projected benefit obligation	58.7	56.3
Return on plan assets	(59.6)	(55.7)
Net amortization and deferral	0.3	0.6
Recognized actuarial loss	15.3	18.8
Curtailement charges	<u>(0.3)</u>	<u>1.2</u>
Net periodic pension expense	<u>\$ 15.8</u>	<u>28.4</u>

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The assumptions used in determining net periodic pension expense and accrued pension costs shown above are as follows:

	<u>2012</u>	<u>2011</u>
Discount rates for obligations at year end:		
MedStar Health, Inc. Pension Equity Plan	4.60%	5.85%
MedStar Health, Inc. Cash Balance Retirement Plan	4.55	5.70
MedStar Health, Inc. Supplemental Executive Pension Plan	N/A	0.80
MedStar St. Mary's Hospital Pension Plan	4.35	5.60
Rate of compensation increase for obligations at year end:		
MedStar Health, Inc. Cash Balance Retirement Plan	N/A	4.00%
MedStar Health, Inc. Supplemental Executive Pension Plan	N/A	3.50
Discount rates for pension cost:		
MedStar Health, Inc. Pension Equity Plan – July 1 – June 30	5.85%	5.95%
MedStar Health, Inc. Cash Balance Retirement Plan – July 1 – April 30	N/A	5.75
MedStar Health, Inc. Cash Balance Retirement Plan – May 1 – June 30	N/A	5.65
MedStar Health, Inc. Cash Balance Retirement Plan – July 1 – June 30	5.70%	N/A
MedStar Health, Inc. Supplemental Executive Pension Plan – July 1 – March 31	N/A	5.30
MedStar Health, Inc. Supplemental Executive Pension Plan – April 1 – June 30	N/A	0.75
MedStar Health, Inc. Supplemental Executive Pension Plan – July 1 – March 15	0.80%	N/A
MedStar St. Mary's Hospital Pension Plan – July 1 – June 30	5.60	5.40
Expected long-term rate of return on plan assets – PEP and CBRP	8.25%	8.25%
Expected long-term rate of return on plan assets – MedStar St. Mary's Hospital	7.75	7.75
Rate of compensation increase for pension cost:		
MedStar Health, Inc. Cash Balance Retirement Plan – July 1 – June 30	4.00%	4.00%
MedStar Health, Inc. Supplemental Executive Pension Plan	N/A	3.50

The Corporation also has various contributory, tax deferred annuity and savings plans with participation available to certain employees. The Corporation matches employee contributions up to 3.0% of compensation in certain plans. The Corporation contributed approximately \$23.5 and \$20.7 during the years ended June 30, 2012 and 2011, respectively. The Corporation approved the temporary suspension of

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the 2-3% fixed tenure-based discretionary contribution to the 403(b) plan for the calendar years 2012 and 2011.

#### (8) Business and Credit Concentrations

The Corporation provides healthcare services through its inpatient and outpatient care facilities located in the State of Maryland and the District of Columbia. The Corporation generally does not require collateral or other security in extending credit; however it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits receivable under their health insurance programs, plans or policies (e.g., Medicare, Medicaid, Blue Cross, Workers' Compensation, health maintenance organizations (HMOs) and commercial insurance policies).

A summary of net patient service revenue by major category of payor for the years ended June 30, 2012 and 2011 is as follows:

	<u>2012</u>	<u>2011</u>
Medicare	35%	34%
Medicaid	14	14
Carefirst Blue Cross Blue Shield	18	18
Other commercial and managed care payors	25	27
Self-pay	8	7
	<u>100%</u>	<u>100%</u>

A summary of net patient receivables by major category of payor as of June 30, 2012 and 2011 is as follows:

	<u>2012</u>	<u>2011</u>
Medicare	23%	23%
Medicaid	12	14
Carefirst Blue Cross Blue Shield	13	13
Other commercial and managed care payors	40	36
Self-pay	12	14
	<u>100%</u>	<u>100%</u>

The Corporation's policy is to write-off all patient accounts that have been identified as uncollectible. An allowance for uncollectible accounts is recorded for accounts not yet written off which are expected to become uncollectible in future periods.

Under the Maryland Health Services Cost Review Commission (HSCRC) rate methodology, amounts payable for services in 2012 and 2011 to Maryland hospital patients under the Medicare and Medicaid insurance programs are computed at 94% of regulated charges and hospital patients under the Blue Cross and approved health maintenance organization insurance programs are computed at 98% of regulated

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charges. Maryland accounts receivable from these third-party payors have been adjusted to reflect the difference between charges and the payable amounts.

Certain Maryland-based hospital charges are subject to review and approval by the HSCRC.

The HSCRC has jurisdiction over hospital reimbursement in Maryland by agreement with the Centers for Medicare and Medicaid Services (CMS). This agreement is based on a waiver from the Medicare Prospective Payment System reimbursement principles granted under Section 1814(b) of the Social Security Act. The waiver will continue as long as cumulative comparisons of cost per admission between Maryland and the nation continue to be favorable. Management believes that the waiver will remain in effect at least through June 30, 2013.

Effective July 1, 2000 through June 30, 2003 under a contract with the HSCRC and the Maryland Hospitals, a charge per case methodology was implemented to more effectively tie compliance standards to waiver performance. Under this methodology, actual charges per case are required to meet hospital specific targets established by the HSCRC, which are adjusted for changes in actual case-mix. The HSCRC and Maryland Hospitals completed a three year contract that expired on June 30, 2006 and was renewed yearly. During the Corporation's fiscal year, the Maryland Hospitals signed a new three year agreement that changed the charge per case target to a charge per episode target defining episode as inpatient care provided within 30 days. The HSCRC implemented an observation status change that became effective July 1, 2010 in which one-day stay cases that used to be counted as admissions are now considered outpatient visits.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount. Management periodically reviews recorded amounts receivable from or payable to third party payors and may adjust these balances as new information becomes available. In addition, revenue received under certain third-party agreements is subject to audit. During 2012 and 2011, certain of the Corporation's prior year third party cost reports were audited and settled, or tentatively settled, by third party payors. Adjustments resulting from such audits and management reviews of unaudited years and open claims are reflected as adjustments to revenue in the year that the adjustment becomes known. The effect of these adjustments was to increase net patient service revenue by \$13.4 and \$6.0 during the years ended June 30, 2012 and 2011, respectively. Although certain other prior year cost reports submitted to third party payors remain subject to audit and retroactive adjustment, management does not expect any material adverse settlements.

Through its MedStar Family Choice, Inc. subsidiary, the Corporation enters into fee-for-service and capitation agreements with independent health professionals and organizations to provide covered services to eligible enrollees where such services cannot be provided by its employed physicians or controlled entities. Medical and clinical expenses from these agreements include claim payments, capitation payments, and estimates of outstanding claims liabilities for services provided prior to the balance sheet date. The estimates of outstanding claims liabilities (\$12.8 and \$14.9 at June 30, 2012 and 2011, respectively), are based on management's analysis of historical claims paid reports and as well as review of health services utilization during the period. Changes in these estimates are recorded in the period of

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change. Claims payments and capitation payments are expensed in the period services are provided to eligible enrollees.

#### **(9) Certain Significant Risks and Uncertainties**

The Corporation provides general acute healthcare services in the State of Maryland and the District of Columbia. As a healthcare provider, the Corporation is subject to certain significant inherent risks, including the following:

- Dependence on revenues derived from reimbursement by the Federal Medicare and state Medicaid programs;
- Regulation of hospital rates by the State of Maryland Health Services Cost Review Commission;
- Government regulation, government budgetary constraints and proposed legislative and regulatory changes, and;
- Lawsuits alleging malpractice or other claims.

Such inherent risks require the use of certain management estimates in the preparation of the Corporation's consolidated financial statements and it is reasonably possible that a change in such estimates may occur.

The Medicare and state Medicaid reimbursement programs represent a substantial portion of the Corporation's revenues and the Corporation's operations are subject to a variety of other Federal, state and local regulatory requirements. In addition, changes in federal and state reimbursement funding mechanisms and related government budgetary constraints could have a significant adverse effect on the Corporation. Similarly, failure by the Corporation to maintain required regulatory approvals and licenses and/or changes in related regulatory requirements could have a significant adverse effect.

The healthcare industry is subject to numerous laws and regulations from federal, state and local governments, and the government has increased enforcement of Medicare and Medicaid anti-fraud and abuse laws, as well as physician self referral laws (STARK law and regulation). The Corporation's compliance with these laws and regulations is subject to periodic governmental review, which could result in enforcement actions unknown or unasserted at this time. The Corporation is aware of certain asserted and unasserted legal claims by the government, and has provided requested information. The final outcomes of these government investigations cannot be determined at this time.

Recent federal initiatives have prompted a national review of federally funded healthcare programs. To this end, the federal government, and many states, implemented programs to audit and recover potential overpayments to providers from the Medicare and Medicaid programs. Since June 2010, the Corporation's hospitals have received audit requests from the Medicare Recovery Audit Contractor (RAC) program. These RAC audit requests have focused on medical necessity of inpatient admissions and hospital coding practices. In addition, the hospitals have continued to receive routine audit requests from other Medicare contractors and the Office of Inspector General. The Corporation's hospitals have cooperated with each of these audit requests and implemented a program to monitor compliance with applicable laws and regulations.

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As a result of recently enacted and pending federal health care reform legislation, substantial changes are anticipated in the United States health care system. Such legislation includes numerous provisions affecting the delivery of health care services, the financing of health care costs, reimbursement to health care providers and the legal obligations of health insurers, providers and employers. These provisions are currently slated to take effect at specified times over the next decade. This federal health care reform legislation did not affect the 2012 or 2011 consolidated financial statements.

The Corporation, in the normal course of business, is a party to legal and regulatory proceedings. These include a lawsuit filed in June 2011 by several MedStar Washington Hospital Center employees alleging violations by the Corporation of wage-hour laws. The plaintiffs in this action are seeking certification of a class that would include hourly employees at all of the Corporation's hospitals. The Corporation is opposing class certification and taking other steps to defend itself and the hospitals in this litigation. The final outcome of this litigation cannot be determined at this time.

#### (10) Self-Insurance Programs

The Corporation maintains self-insurance programs for professional and general liability risks, employee health and workers' compensation. Estimated liabilities have been recorded based on actuarial estimation of reported and incurred but not reported claims. The combined accrued liabilities for these programs as of June 30, 2012 and 2011 were as follows:

	<u>2012</u>	<u>2011</u>
Professional and general liability	\$ 257.7	207.4
Employee health	18.3	19.3
Workers' compensation	31.7	27.9
Total liabilities	<u>307.7</u>	<u>254.6</u>
Less current portion	<u>(79.5)</u>	<u>(58.0)</u>
	<u>\$ 228.2</u>	<u>196.6</u>

The Corporations' self insurance program for professional and general liability is responsible for the following exposures at June 30, 2012:

- (a) For professional liability, the first \$5.0 exposure for each claim with an inner aggregate of \$2.5 for the period July 1, 2010 through December 31, 2010. For the period January 1, 2011 through June 30, 2012, the Corporation is responsible for the first \$5.0 exposure for each claim plus an inner aggregate (effective January 1, 2011, the inner aggregate was changed from a \$2.5 annual inner aggregate to a \$5.0 inner aggregate spread over a 24-month exposure period ending December 31, 2012; effective January 1, 2012 the inner aggregate was changed to a \$5.0 inner aggregate with a \$7.5 aggregate spread over a 36-month exposure period dated January 1, 2011. For MedStar Montgomery Medical Center and MedStar St. Mary's Hospital, the Corporation is responsible for the first \$2.0 exposure for each claim (also subject to the inner aggregate structures noted above).

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- (b) For general liability, the Corporation is responsible for the first \$3.0 exposure for each claim (for MedStar Montgomery Medical Center, the first \$2.0 exposure for each claim).

Commercial excess re-insurance has been purchased above this self-insured retention in multiple layers and in twin towers. Each tower has seven layers of excess re-insurance coverage. These seven layers combine to provide up to \$100.0 per claim and \$100.0 in the annual aggregate for professional liability and general liability exposure. The Corporation maintains reinsurance contracts with various highly rated commercial insurance companies.

The professional and general liabilities at June 30, 2012 and 2011 have been discounted at a rate of 1.25% and 3.75%, respectively. The workers' compensation liabilities at June 30, 2012 and 2011 have been discounted at a rate of 1.5% and 3.5%, respectively.

Assets available to fund these liabilities are held in separate accounts (see note 2). Contributions required to fund professional and general liability, employee health benefits and workers' compensation programs are determined by the plans' administrators based on appropriate actuarial assumptions. The professional and general liability programs are administered through an offshore wholly owned captive insurance company, Greenspring Financial Insurance Limited (GFIL), which is domiciled in Grand Cayman Island.

Effective November 1, 2011, MedStar St. Mary's Hospital transitioned from its previous professional and general liability coverage with a commercial insurer to coverage under GFIL. Under the prior program, MedStar St. Mary's Hospital professional liability insurance coverage was issued on a claims made basis, with \$1.0 per incident coverage, up to a maximum of \$3.0 annually and the general liability policy was issued on an occurrence basis with \$1.0 each occurrence, up to a maximum of \$3.0 annually. MedStar St. Mary's Hospital also maintained an umbrella excess policy in the amount of \$5.0. At the time of the transition of the primary coverage to GFIL, the tail liability for the claims made program was moved into GFIL.

The Corporation, in the normal course of business, is a party to a number of legal and regulatory proceedings. Management does not expect that the results of these proceedings will have a material adverse effect on the consolidated financial position or results of operations of the Corporation.



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**(11) Unrestricted Net Assets**

The Corporation accounts for and present noncontrolling interests in a consolidated subsidiary as a separate component of the appropriate class of consolidated net assets. The income attributable to noncontrolling interests is included within operating income on the consolidated statements of operations and changes in net assets. The following table presents a reconciliation of the changes in consolidated unrestricted net assets attributable to the Corporation's controlling interest and noncontrolling interest, including amounts such as the performance indicator and other changes in unrestricted net assets as of and for the years ended June 30, 2012 and 2011:

	<u>MedStar Health, Inc.</u>	<u>Noncontrolling interests</u>	<u>Total unrestricted net assets</u>
Balance as of June 30, 2010	\$ 643.9	9.4	653.3
Excess of revenues over expenses	208.1	4.1	212.2
Change in funded status of defined benefit plans	47.4	—	47.4
Net assets released for property and equipment	5.0	—	5.0
Distributions to noncontrolling interests	—	(5.7)	(5.7)
Increase (decrease) in unrestricted net assets	<u>260.5</u>	<u>(1.6)</u>	<u>258.9</u>
Balance as of June 30, 2011	<u>904.4</u>	<u>7.8</u>	<u>912.2</u>
Excess of revenues over expenses	65.7	4.2	69.9
Change in funded status of defined benefit plans	(250.8)	—	(250.8)
Net assets released for property and equipment	7.6	—	7.6
Distributions to noncontrolling interests	—	(3.3)	(3.3)
(Decrease) increase in unrestricted net assets	<u>(177.5)</u>	<u>0.9</u>	<u>(176.6)</u>
Balance as of June 30, 2012	<u>\$ 726.9</u>	<u>8.7</u>	<u>735.6</u>

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**(12) Temporarily and Permanently Restricted Net Assets**

Temporarily and permanently restricted net assets as of June 30, 2012 and 2011 are available for the following purposes:

	<b>2012</b>	<b>2011</b>
Temporary restrictions:		
Interest in net assets of foundation	\$ 48.5	49.2
Other	32.0	36.2
	\$ 80.5	85.4
Permanent restrictions:		
Investments to be held in perpetuity, the income from which is available to support health care services	\$ 37.4	37.7

Temporarily restricted net assets are available for the purposes of purchasing property and equipment, providing health education, research and other healthcare services.

**(13) Endowment Net Assets**

The Corporation's endowments consist of individual donor-restricted funds established for a variety of purposes. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

**(a) Interpretation of Relevant Law**

The Corporation has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Corporation classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by SPMIFA. In accordance with SPMIFA, the Corporation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of the Corporation and the donor-restricted endowment fund
- (3) General economic conditions

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- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the Corporation
- (7) The investment policies of the Corporation.

**(b) Endowment Net Assets Consist of the Following at June 30, 2012**

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (0.4)	1.4	37.4	38.4
Total endowed net assets	<u>\$ (0.4)</u>	<u>1.4</u>	<u>37.4</u>	<u>38.4</u>

**(c) Endowment Net Assets Consist of the Following at June 30, 2011**

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (0.2)	1.7	37.7	39.2
Total endowed net assets	<u>\$ (0.2)</u>	<u>1.7</u>	<u>37.7</u>	<u>39.2</u>

**(d) Funds with Deficiencies**

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or SPMIFA requires the Corporation to retain as a fund of perpetual duration. In accordance with U.S. generally accepted accounting principles, deficiencies of this nature that are reported in unrestricted net assets were \$0.4 and \$0.2 as of June 30, 2012 and 2011, respectively. These deficiencies resulted from unfavorable market fluctuations.

**(e) Investment Strategies**

The Corporation has adopted policies for corporate investments, including endowment assets, that seek to maximize risk-adjusted returns with preservation of principal. Endowment assets include those assets of donor-restricted funds that the Corporation must hold in perpetuity or for a donor-specified period(s). The endowment assets are invested in a manner that is intended to hold a mix of investment assets designed to meet the objectives of the account. The Corporation expects its

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endowment funds, over time, to provide an average rate of return that generates earnings to achieve the endowment purpose.

To satisfy its long-term rate-of-return objectives, the Corporation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Corporation employs a diversified asset allocation structure to achieve its long-term return objectives within prudent risk constraints.

The Corporation monitors the endowment funds returns and appropriates average returns for use. In establishing this practice, the Corporation considered the long-term expected return on its endowment. This is consistent with the Corporation's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

#### **(14) Income Taxes**

The Corporation and the majority of its subsidiaries are not-for-profit corporations as defined in Section 501(c)(3) of the Internal Revenue Code (the Code) and are exempt from federal income taxes under Section 501(a) of the Code. The Corporation's tax-exempt businesses generate nominal amounts of unrelated business income subject to income tax. For corporate income tax purposes, the Corporation has two consolidated groups of for-profit, taxable entities. The parent companies of these groups are Parkway Ventures, Inc. and MedStar Enterprises, Inc.

The Corporation's taxable subsidiaries have approximately \$233.0 of net operating loss (NOL) carryforwards as of June 30, 2012, which expire in varying periods through 2032, available to offset future taxable income. This NOL carryforward represents \$88.5 of gross deferred tax assets. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. At June 30, 2012, the Corporation increased its net deferred tax asset by \$4.3, which was recorded in nonoperating income. At June 30, 2011, the Corporation increased its net deferred tax asset by \$1.4, which was recorded in nonoperating income. The remaining amount of the deferred tax asset considered realizable, \$29.7, could be reduced if estimates of future taxable income during the carry forward period are reduced. The current tax provisions for the years ended June 30, 2012 and 2011 were immaterial.

**MEDSTAR HEALTH, INC.**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(Dollars in millions)

**(15) Charity Care**

The Corporation's hospitals utilize a cost to charge ratio methodology to convert charity care to cost. The estimated cost of services provided is determined based on the relationship of total operating costs to gross charges. Total operating costs for purposes of this ratio exclude bad debt expense as well as costs associated with community benefit activities. Total gross patient charges are then offset with any related reimbursements. The Corporation provided \$48.2 and \$41.4 of charity care at cost during the years ended June 30, 2012 and 2011, respectively, based on the cost to charge ratio.

In addition to charity care, the Corporation funds numerous programs designed to benefit the healthcare interests of the communities it serves, examples of which are: health education programs and services, health information and referral services, school-based clinics, public health screenings and home care. The costs associated with these programs are recorded in the appropriate operating expense categories.

**(16) Leases**

The Corporation is obligated under various operating leases with initial terms of one year or more. Aggregate future minimum payments as of June 30, 2012 are as follows:

2013	\$	39.4
2014		32.3
2015		19.5
2016		14.9
2017		10.4
2018 and thereafter		<u>35.3</u>
Total minimum lease payments	\$	<u><u>151.8</u></u>

Certain leases include provisions allowing the minimum rental payments to be adjusted annually for increases in operating costs and, in some cases, real estate taxes attributable to leased property. Total rental expense for all operating leases amounted to approximately \$59.0 and \$59.1 during the years ended June 30, 2012 and 2011, respectively.

**(17) Commitments and Contingencies**

In February 2000 and on June 30, 2000, the Corporation and Georgetown University (the University) signed certain definitive agreements whereby the Corporation would receive through purchase or capital lease substantially all of the assets (including working capital) owned by the University that constitutes the MedStar Georgetown University Hospital, the Community Practice Network, the Faculty Practice Group and certain office buildings and a parking lot on the campus (collectively referred to as the Transferred Businesses). These agreements became effective July 1, 2000 and transferred control of the identified physical plant and other real property assets of the Transferred Businesses to the Corporation for use as an academic medical center for a minimum of ninety-eight years. At the end of the one hundred and fifty year lease term (including a fifty-two year renewal), the University shall convey all leased assets, excluding the underlying land, to the Corporation for a nominal amount and enter into a rent-free ground lease for the

## MEDSTAR HEALTH, INC.

### Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(Dollars in millions)

Corporation's use. This transaction was accounted for under the purchase method of accounting effective July 1, 2000.

In recognition of the value of the transaction, the Corporation shall annually pay the University 50% of the amount by which the combined operating earnings before interest, taxes, depreciation and amortization (EBITDA), as defined in the asset purchase agreement, of certain entities of the Corporation in the Washington D.C. area (collectively referred to as the Washington Clinical Enterprises) exceeds \$60.0, subject to certain adjustments. These additional payments expire when cumulative payments reach \$70.0. The amounts due under these agreements were approximately \$10.0 and \$0 at June 30, 2012 and 2011, respectively. The Corporation paid \$1.7 to the University through the year ended June 30, 2012.

The Corporation also entered into an Academic Affiliation and Operations Agreement (Affiliation Agreement) with the University. The purpose of this agreement is to make available to the University the facilities of the Transferred Businesses and provide the Corporation with a first-class University medical center. The University shall make payments to the Corporation determined by multiplying the University School of Medicine's total undergraduate tuition revenue by 36% for providing teaching services. The Corporation recognized \$12.3 and \$15.0 of tuition revenue during the years ended June 30, 2012 and 2011, respectively. In support of academic programs at the University, for each fiscal year following the termination of the additional payment terms in the asset purchase agreement described above, the Corporation shall pay to the University 17.5% of the operating EBITDA of the Washington Clinical Enterprises in excess of \$60.0, subject to certain adjustments. No amounts were due under this Affiliation Agreement at June 30, 2012.

The Corporation and the University also entered into a Research Agreement to sustain and advance a program of health-related University research at the Transferred Business facilities. Under this agreement the University is required to reimburse the Corporation for certain costs incurred by the Corporation in support of University sponsored research. Amounts reimbursed to the Corporation were \$3.0 and \$2.8 for the years ended June 30, 2012 and 2011, respectively.

MedStar Georgetown University Hospital and the University are parties to a fixed fee shared services agreement. Georgetown University provided to MedStar Georgetown University Hospital the following services: utilities, telephone/IT services, transportation services and library services. Expenses charged for such services were \$12.3 and \$11.9 for 2012 and 2011, respectively.

The MedStar Washington Hospital Center campus is subject to the lien of a Permitted Encumbrance in the amount of \$21.5 to the United States government. This encumbrance was created in the deed of the hospital property from the United States government to MedStar Washington Hospital Center in February 1960. There is no repayment date for this lien stated in the deed. Under enabling legislation, repayment could be required after a determination that the property is no longer required for hospital services or the property is disposed of, in which event all or a portion of the lien may be payable to the government. This lien is subordinated to the Deed of Trust on the MedStar Washington Hospital Center campus.

**MEDSTAR HEALTH, INC.**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(Dollars in millions)

**(18) Functional Expenses**

The Corporation considers integrated health services, research and management and general to be its primary functional categories for purposes of expense classification. Management and general include information systems, general corporate management, advertising and marketing. Functional categories of expenses for the years ended June 30, 2012 and 2011 are as follows:

	<u>2012</u>	<u>2011</u>
Integrated health services	\$ 3,321.8	3,180.0
Management and general	713.1	713.3
Research	30.9	32.5
Fundraising	7.8	8.4
	<u>\$ 4,073.6</u>	<u>3,934.2</u>

**(19) Subsequent Events**

Management evaluated all events and transactions that occurred after June 30, 2012 and through October 10, 2012. In July 2012, the Corporation drew \$9.0 from the line of credit to provide interim financing to a joint venture in which the Corporation maintains an equity interest. The joint venture will be liquidated and as a result repayment is expected within the next six months.

The Corporation entered into an agreement with Southern Maryland Hospital on July 27, 2012, with the intention to purchase certain assets with respect to the business. The transaction is under regulatory review and is expected to close in the Corporation's second quarter of fiscal year 2013. The Corporation did not have any events that were required to be recognized.

## **SUPPLEMENTARY SCHEDULES**



**MEDSTAR HEALTH, INC.**  
 Consolidating Balance Sheet Information  
 June 30, 2012  
 (Dollars in millions)

Assets	MedStar Franklin Square Medical Center	MedStar Good Samaritan Hospital	MedStar Harbor Hospital	MedStar Montgomery Medical Center	MedStar St. Mary's Hospital	MedStar Union Memorial Hospital	Helix Resource Management	Medstar Family Choice	Church Home Corp.	All Other MedStar Entities	Eliminations	Consolidated Totals
Current assets:												
Cash and cash equivalents	\$ 0.4	—	—	36.0	44.5	—	—	38.2	0.4	449.1	—	568.6
Investments	—	—	—	—	0.2	—	—	0.3	—	18.5	—	19.0
Assets whose use is limited or restricted	—	—	—	—	0.2	—	—	—	—	63.2	—	63.4
Receivables:												
From patient services (less allowances for uncollectible accounts of \$189.7 in 2012)	71.0	41.7	24.4	16.3	20.4	61.1	0.3	1.0	—	311.4	(6.9)	540.7
Other	1.4	2.3	1.7	0.3	0.2	2.6	—	1.1	—	40.9	(1.4)	49.1
Intercompany receivables	—	—	—	—	—	—	—	—	0.6	1.0	(1.6)	—
	<u>72.4</u>	<u>44.0</u>	<u>26.1</u>	<u>16.6</u>	<u>20.6</u>	<u>63.7</u>	<u>0.3</u>	<u>2.1</u>	<u>0.6</u>	<u>353.3</u>	<u>(9.9)</u>	<u>589.8</u>
Inventories	5.9	2.7	2.2	2.5	2.6	6.1	—	—	—	26.5	—	48.5
Prepays and other current assets	1.5	0.5	0.5	0.9	0.9	1.2	—	0.1	—	24.9	—	30.5
Total current assets	<u>80.2</u>	<u>47.2</u>	<u>28.8</u>	<u>56.0</u>	<u>69.0</u>	<u>71.0</u>	<u>0.3</u>	<u>40.7</u>	<u>1.0</u>	<u>935.5</u>	<u>(9.9)</u>	<u>1,319.8</u>
Investments	—	—	—	—	2.1	—	—	9.4	—	600.8	—	612.3
Assets whose use is limited or restricted	0.5	0.1	—	—	1.3	51.3	—	—	9.4	313.5	—	376.1
Property and equipment, net	227.7	71.8	32.2	86.1	74.9	90.5	—	0.2	—	454.2	—	1,037.6
Interest in net assets of foundation	—	48.5	—	—	—	—	—	—	—	—	—	48.5
Other assets	0.7	3.7	0.3	0.3	7.2	3.3	—	0.3	—	497.7	(363.0)	150.5
Total assets	<u>\$ 309.1</u>	<u>171.3</u>	<u>61.3</u>	<u>142.4</u>	<u>154.5</u>	<u>216.1</u>	<u>0.3</u>	<u>50.6</u>	<u>10.4</u>	<u>2,801.7</u>	<u>(372.9)</u>	<u>3,544.8</u>

**MEDSTAR HEALTH, INC.**  
Consolidating Balance Sheet Information  
June 30, 2012  
(Dollars in millions)

Liabilities and Net Assets	MedStar Franklin Square Medical Center	MedStar Good Samaritan Hospital	MedStar Harbor Hospital	MedStar Montgomery Medical Center	MedStar St. Mary's Hospital	MedStar Union Memorial Hospital	Helix Resource Management	Medstar Family Choice	Church Home Corp.	All Other MedStar Entities	Eliminations	Consolidated Totals
Current liabilities:												
Accounts payable and accrued expenses	\$ 18.3	13.4	10.2	6.4	4.0	22.2	0.6	14.9	—	240.5	(7.0)	323.5
Accrued salaries, benefits, and payroll taxes	23.9	15.3	11.4	7.0	5.0	20.0	—	0.6	—	170.1	—	253.3
Amounts due to third-party payors, net	14.6	6.8	5.8	4.8	3.9	11.7	—	—	—	13.5	—	61.1
Intercompany payables	—	—	—	22.2	4.5	—	—	—	—	(117.2)	90.5	—
Current portion of long-term debt	—	—	—	—	1.3	0.5	—	—	—	16.7	—	18.5
Current portion of self insurance liabilities	1.2	0.5	0.2	1.2	—	0.3	—	—	—	76.1	—	79.5
Other current liabilities	8.5	6.6	8.6	0.5	6.8	10.6	—	9.9	0.2	71.6	(22.5)	100.8
Total current liabilities	66.5	42.6	36.2	42.1	25.5	65.3	0.6	25.4	0.2	471.3	61.0	836.7
Long-term debt, net of current portion	—	—	—	8.1	1.2	0.9	—	—	—	999.9	—	1,010.1
Self insurance liabilities, net of current portion	4.3	1.9	1.0	—	—	1.6	—	—	—	219.4	—	228.2
Pension liabilities	—	—	—	—	2.6	—	—	—	—	467.7	—	470.3
Other long-term liabilities, net of current portion	7.8	12.7	8.2	2.3	1.9	12.4	—	0.1	0.1	173.4	(72.9)	146.0
Total liabilities	78.6	57.2	45.4	52.5	31.2	80.2	0.6	25.5	0.3	2,331.7	(11.9)	2,691.3
Net assets:												
Common stock	—	—	—	—	—	—	0.1	—	1.7	8.6	(10.4)	—
Additional paid in capital	0.5	—	—	—	1.0	—	—	22.9	—	238.4	(262.8)	—
Unrestricted MedStar Health, Inc.	229.5	65.5	15.9	89.9	121.9	107.4	(0.4)	2.2	7.9	174.9	(87.8)	726.9
Unrestricted noncontrolling interests	—	—	—	—	—	—	—	—	—	8.7	—	8.7
Temporarily restricted	0.5	48.6	—	—	0.3	2.4	—	—	0.3	28.4	—	80.5
Permanently restricted	—	—	—	—	0.1	26.1	—	—	0.2	11.0	—	37.4
Total net assets (deficit)	230.5	114.1	15.9	89.9	123.3	135.9	(0.3)	25.1	10.1	470.0	(361.0)	853.5
Total liabilities and net assets	\$ 309.1	171.3	61.3	142.4	154.5	216.1	0.3	50.6	10.4	2,801.7	(372.9)	3,544.8

See accompanying independent auditors' report.

## MEDSTAR HEALTH, INC.

## Consolidating Statements of Operations and Summary Changes in Net Assets Information

Year ended June 30, 2012

(Dollars in millions)

	MedStar Franklin Square Medical Center	MedStar Good Samaritan Hospital	MedStar Harbor Hospital	MedStar Montgomery Medical Center	MedStar St. Mary's Hospital	MedStar Union Memorial Hospital	Helix Resource Management	Medstar Family Choice	Church Home Corp.	All Other MedStar Entities	Eliminations	Consolidated Totals
Operating revenues:												
Net patient service revenue:												
Hospital inpatient services	\$ 262.5	191.1	124.3	87.5	57.9	232.3	—	—	—	1,218.4	(28.8)	2,145.2
Hospital outpatient services	200.8	123.8	72.9	60.5	70.2	170.5	—	—	—	656.9	(12.3)	1,343.3
Physician services:	—	—	—	—	—	—	2.5	—	—	254.7	—	257.2
Other patient service revenue	—	—	—	—	2.5	—	—	—	—	138.7	(17.3)	123.9
Total net patient service revenue	463.3	314.9	197.2	148.0	130.6	402.8	2.5	—	—	2,268.7	(58.4)	3,869.6
Premium revenue	—	—	—	—	—	—	—	118.3	—	0.5	(2.5)	116.3
Other operating revenue	8.2	5.1	12.0	3.6	6.4	15.2	—	—	—	376.3	(236.8)	190.0
Net operating revenues	471.5	320.0	209.2	151.6	137.0	418.0	2.5	118.3	—	2,645.5	(297.7)	4,175.9
Operating expenses:												
Personnel	230.7	155.0	98.8	68.0	62.9	193.8	—	4.5	—	1,336.8	1.5	2,152.0
Supplies	72.8	48.4	32.9	24.7	23.4	81.1	—	0.2	—	351.1	(4.9)	629.7
Purchased services	44.2	42.8	21.9	22.6	13.0	51.8	2.8	99.3	—	301.0	(85.0)	514.4
Other operating	54.3	38.1	38.2	12.5	13.1	47.6	—	6.3	—	383.5	(209.3)	384.3
Provision for bad debts	22.3	12.0	10.2	5.1	5.2	16.0	(0.3)	—	—	120.8	—	191.3
Interest expense	11.1	3.0	2.3	1.4	1.3	4.0	—	—	—	22.3	—	45.4
Depreciation and amortization	22.8	12.1	7.5	8.5	8.5	18.2	—	—	—	78.9	—	156.5
Total operating expenses	458.2	311.4	211.8	142.8	127.4	412.5	2.5	110.3	—	2,594.4	(297.7)	4,073.6
Earnings (loss) from operations	13.3	8.6	(2.6)	8.8	9.6	5.5	—	8.0	—	51.1	—	102.3
Nonoperating gains (losses):												
Investment income	—	—	0.1	0.2	0.1	0.4	—	—	0.2	13.6	—	14.6
Net realized losses on investments	—	—	—	—	—	(0.7)	—	—	(0.1)	(8.9)	—	(9.7)
Unrealized loss on derivative instrumen	—	—	—	—	—	—	—	—	—	(7.8)	—	(7.8)
Unrealized losses on trading investment:	—	—	—	—	—	(1.1)	—	—	(0.4)	(11.6)	—	(13.1)
Equity interest in alternative investment:	—	—	—	—	—	—	—	—	—	(15.4)	—	(15.4)
Income tax benefit (provision)	—	—	—	—	—	—	—	(3.1)	—	6.7	—	3.6
Other nonoperating losses	—	—	—	—	(0.1)	—	—	—	—	(4.5)	—	(4.6)
Excess (deficiency) of revenue over expenses	13.3	8.6	(2.5)	9.0	9.6	4.1	—	4.9	(0.3)	23.2	—	69.9
Change in funded status of defined benefit plans	—	—	—	—	—	—	—	—	—	(250.8)	—	(250.8)
Change in restricted investments	—	0.1	—	—	—	(0.5)	—	—	—	—	—	(0.4)
Restricted contributions, net assets released from restrictions and other	0.6	(0.8)	—	0.2	(4.5)	0.2	—	—	—	3.8	—	(0.5)
Transfer from (to) parent, net	(19.6)	(9.7)	(2.3)	—	27.9	(5.9)	—	(3.3)	(0.4)	13.3	—	—
Total changes in net assets	\$ (5.7)	(1.8)	(4.8)	9.2	33.0	(2.1)	—	1.6	(0.7)	(210.5)	—	(181.8)

See accompanying independent auditors' report.